

COMMONWEALTH OF VIRGINIA  
STATE CORPORATION COMMISSION

AT RICHMOND, JULY 14, 2005

APPLICATION OF

VIRGINIA NATURAL GAS, INC.

For approval of a performance based rate  
regulation methodology pursuant  
to Va. Code § 56-235.6

CASE NO. PUE-2005-00057

GENERAL RATE CASE FILING OF

VIRGINIA NATURAL GAS, INC.

For investigation of justness and reasonableness  
of current rates, charges, and terms and conditions  
of service in compliance with prior Commission Order

CASE NO. PUE-2005-00062

ORDER FOR NOTICE AND HEARING

On July 1, 2005, Virginia Natural Gas, Inc. ("VNG" or the "Company"), filed with the State Corporation Commission ("Commission") an Application for approval of a performance based rate regulation methodology ("PBR Plan") pursuant to § 56-235.6 of the Code of Virginia ("Code"). VNG requests that the Commission approve the PBR Plan so that it becomes effective on January 1, 2006, to allow the Company the opportunity to make investment decisions that will add capacity before the 2007-2008 winter, when VNG states its capacity will be deficient to meet its reserve margin.

In addition, pursuant to the Commission's April 29, 2005, Order on Motions in Case Nos. PUE-2002-00237 and PUE-2005-00028 ("April 29, 2005, Order"), VNG filed as part of the Application a fully-adjusted cost of service study and the accompanying rate schedules in accordance with the Commission's Rules Governing Utility Rate Increase Applications and Annual Informational Filings, 20 VAC 5-200-30 ("General Rate Case Filing"). The Company

states that the General Rate Case Filing supports an increase to its annual revenues of \$19,212,972, which the Company proposes not to implement if the Commission approves the PBR Plan.

The Company states that the PBR Plan would: (1) freeze the non-gas cost portion of rates for five years beginning January 1, 2006; (2) prohibit the Company from seeking, at the expiration of the five-year freeze, further regulatory treatment on the outstanding portion of any unrecovered purchase premium attendant to AGL Resources Inc.'s acquisition of VNG, representing a potential write-off of approximately \$114 million; (3) allow VNG to request an increase in the frozen rates in connection with (i) any changes in the taxation by the Commonwealth of incumbent natural gas distribution utility revenues, and (ii) any financial distress of VNG beyond its control; (4) forego the Company's proposed \$19,212,972 in additional annual operating revenues; and (5) commit VNG to meet the natural gas capacity needs in Hampton Roads during the rate freeze period.

Next, the Company's General Rate Case Filing includes data to support the additional annual revenue requirement, proposed rate of return, cost of service, rate base, and appropriate capital structure and cost of debt financing. The General Rate Case Filing also includes changes to reflect the use of the interest rate set by the Commission in Case No. PUE-2003-00224 to accrue interest on Customer Deposits and Pipeline Refunds. This rate would be used to compute the interest to be accrued for both the customer deposits and any pipeline refund included in the Company's Quarterly Billing Adjustment ("QBA").

The General Rate Case Filing also provides for rebilling for metering apparatus failure or other factors that result in an incorrect volume of gas being used to compute a customer's bill. Other changes include: (1) a light up charge to apply to appliances (not just furnaces); (2) the

accrual of carrying charges on the under-collection or over-collection of gas costs and recovery through the QBA; (3) modification to the methodology for returning Interruptible Sales margins and Interruptible Transportation revenues to Firm Sales customers to provide for sharing of all interruptible margins; (4) an update of the parameters that are used in the QBA calculations; (5) setting the commodity charge equal to the monthly weighted average commodity cost of gas for high load factor firm and general firm gas delivery service; (6) modifications to the calculation of the maximum (ceiling) rate for interruptible gas sales service; (7) revisions to the charges for miscellaneous services; and (8) revisions to Rate Schedules 1 through 12 to reflect the annual revenue increase of \$19,212,972, if implemented.

In addition, the Company states that it has revised Rate Schedule 9 to clarify the Company's current operating procedures relative to a customer's use of its volume imbalance during periods of economic curtailment. The Company states that this is not a change in its operating procedure or a change in the rates charged customers served under this rate schedule.

NOW UPON CONSIDERATION of the Application and applicable law, the Commission is of the opinion and finds as follows. These matters shall be docketed, a procedural schedule shall be established, and VNG shall give notice to the public of its request for a PBR Plan and its General Rate Case Filing, all as prescribed below.

The Company's request for a PBR Plan shall be docketed as Case No. PUE-2005-00057, set for hearing, and public notice provided therefor as set forth herein. In addition, pursuant to § 56-235.6 of the Code, until the Commission directs appropriate notice of the Company's PBR Plan, provides an opportunity for hearing, and makes the findings required under § 56-235.6 of the Code, VNG has no authority to implement a PBR Plan. Accordingly, VNG shall not implement a PBR Plan unless and until approved by the Commission.

Likewise, the Company's General Rate Case Filing included within the Application shall be docketed as Case No. PUE-2005-00062, set for hearing, and public notice provided therefor as set forth herein. As explained by the Company in its Application, the Commission's April 29, 2005, Order required VNG to "file a general rate case in full compliance with the Commission's Rules Governing Utility Rate Increase Applications and Annual Informational Filings, 20 VAC 5-200-30, on or before July 1, 2005."<sup>1</sup> The April 29, 2005, Order was issued in response to a Report and motion by the Commission's Staff ("Staff") that, among other things, concluded VNG's rates are no longer just and reasonable and requested the Commission to require VNG to demonstrate why its rates should not be made interim and subject to refund pending final determination of just and reasonable rates. In response to the Staff's request, VNG, among other things: (1) disputed the allegation that its current rates are excessive; (2) argued that the only proper way to address these disputes is in the context of a rate case; and (3) committed to filing a rate case on or before December 31, 2005, which would demonstrate the need for additional revenue.<sup>2</sup> The Commission "agree[d] with the Staff and VNG that these matters should be addressed in a general rate case" and required VNG to "file a general rate case" on or before July 1, 2005.<sup>3</sup>

Accordingly, consistent with and in furtherance of our April 29, 2005, Order requiring the Company to file a general rate case, we find that VNG's General Rate Case Filing shall be accepted for the investigation of the justness and reasonableness of current rates, charges, and terms and conditions of service in compliance with the April 29, 2005, Order and docketed

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<sup>1</sup> April 29, 2005, Order at 5.

<sup>2</sup> See April 29, 2005, Order at 2-3.

<sup>3</sup> April 29, 2005, Order at 4-5.

separately from the PBR Plan. The evidence in this proceeding shall be received concurrently in both of the above-captioned dockets.<sup>4</sup> If the PBR Plan, for example, is not approved or is modified by the Commission in a manner the Company does not choose to accept,<sup>5</sup> the Commission, without additional notice, may take action in the General Rate Case Filing docket establishing just and reasonable rates for VNG pursuant to § 56-235.2 of the Code. In addition, until the Commission directs appropriate notice of the Company's General Rate Case Filing, provides opportunity for hearing, and makes the findings required under § 56-235.2 of the Code, VNG has no authority to implement the increase in rates and charges reflected in the General Rate Case Filing.

Finally, the Company's proposed tariff revisions to Rate Schedule 9 clarifying current operating procedures relative to a customer's use of its volume imbalance during periods of economic curtailment, which VNG describes as not a change in operating procedure or a change in rates, shall be accepted for filing pursuant to § 56-240 of the Code, effective August 1, 2005, subject, however, to the power of the Commission, upon investigation thereafter, to fix and order substituted therefor such rate or rates, tolls, charges, rules, or regulations, as shall be just and reasonable.

Accordingly, IT IS ORDERED THAT:

(1) The Company's request for a PBR Plan is hereby docketed and assigned Case No. PUE-2005-00057.

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<sup>4</sup> However, receiving evidence in this manner does not, for example, represent a finding regarding the legal standards or the relevancy or weight of any particular evidence for either docket.

<sup>5</sup> Pursuant to § 56-235.6 C of the Code, "[i]f the Commission approves the [PBR] application with modifications, the gas utility may, at its option, withdraw its application and continue to be regulated under the form of regulation that existed immediately prior to the filing of the application." The Company may not, however, withdraw its General Rate Case Filing in this matter without further Order of the Commission.

(2) The Company's General Rate Case Filing submitted in accordance with our April 29, 2005, Order on Motions is hereby docketed and assigned Case No. PUE-2005-00062.

(3) The PBR Plan shall not be implemented unless and until approved by the Commission.

(4) The General Rate Case Filing revisions shall not be implemented unless and until approved by the Commission, except that VNG's proposed tariff revisions to Rate Schedule 9 shall be accepted for filing pursuant to § 56-240 of the Code effective August 1, 2005, subject, however, to the power of the Commission, upon investigation thereafter, to fix and order substituted therefor such rate or rates, tolls, charges, rules, or regulations, as shall be just and reasonable.

(5) The Company may withdraw its PBR Plan in accordance with § 56-235.6 C of the Code.

(6) The Company may not withdraw its General Rate Case Filing without further Order of the Commission.

(7) The evidence in this proceeding shall be received concurrently in both of the above-captioned dockets.

(8) A copy of the Application and this Order for Notice and Hearing, as well as other documents now or hereafter filed in these matters, shall be available for public inspection in the Commission's Document Control Center located on the First Floor of the Tyler Building, 1300 East Main Street, Richmond, Virginia, between the hours of 8:15 a.m. and 5:00 p.m., Monday through Friday. A copy of the Application also may be obtained by requesting a copy of the same from counsel for VNG, Edward L. Flippen, Esquire, McGuireWoods, LLP, One James Center, 901 East Cary Street, Richmond, Virginia 23219-4030. Upon receipt of a request

for a copy of the Application, VNG shall serve copies of the same upon the requesting party within three (3) business days of such request. If acceptable to the requesting party, the Company may provide the Application, with or without attachments, by electronic means. In addition, copies of the Commission's Order For Notice and Hearing and other orders entered in these dockets, the Commission's Rules of Practice and Procedure, as well as other information concerning the Commission and the statutes it administers, may be viewed on the Commission's website at <http://www.scc.virginia.gov/caseinfo.htm>.

(9) A public hearing shall be convened on January 24, 2006, at 10:00 a.m., before a Commission Hearing Examiner as appointed below, in the Commission's Courtroom, Second Floor, Tyler Building, 1300 East Main Street, Richmond, Virginia, to receive comments from members of the public and to receive evidence in the above-captioned dockets. Any person not participating as a respondent as provided for below may give oral testimony concerning these cases as a public witness at the hearing. Public witnesses desiring to make statements at the public hearing need only appear in the Commission's Second Floor courtroom in the Tyler Building at the address set forth above prior to 9:45 a.m. on the day of the hearing and register a request to speak with the Commission's bailiff.

(10) On or before August 15, 2005, the Company shall file with the Clerk, State Corporation Commission, c/o Document Control Center, P.O. Box 2118, Richmond, Virginia, 23218-2118, an original and fifteen (15) copies of any additional direct testimony, exhibits and other material supporting its PBR Plan and/or its General Rate Case Filing.

(11) Any interested person may participate as a respondent in this proceeding by filing, on or before October 3, 2005, an original and fifteen (15) copies of a notice of participation with the Clerk at the address in Ordering Paragraph (14), and shall simultaneously serve a copy of the

notice of participation on counsel to VNG at the address in Ordering Paragraph (8). Pursuant to Rule 5 VAC 5-20-80 of the Commission's Rules of Practice and Procedure, any notice of participation shall set forth: (i) a precise statement of the interest of the respondent; (ii) a statement of the specific action sought to the extent then known; and (iii) the factual and legal basis for the action. Interested parties shall refer in all of their filed papers to Case Nos. PUE-2005-00057 and PUE-2005-00062.

(12) Within five (5) business days of receipt of a notice of participation as a respondent, the Company shall serve upon each respondent a copy of this Order for Notice and Hearing, a copy of the Application, and all materials filed by the Company with the Commission, unless these materials have already been provided to the respondent.

(13) On or before November 8, 2005, each respondent may file with the Clerk an original and fifteen (15) copies of any testimony and exhibits by which it expects to establish its case and shall serve copies of the testimony and exhibits on counsel to the Company and on all other respondents. The respondent shall comply with the Commission's Rules of Practice and Procedure, including: 5 VAC 5-20-140, *Filing and service*; 5 VAC 5-20-150, *Copies and format*; and 5 VAC 5-20-240, *Prepared testimony and exhibits*.

(14) On or before November 8, 2005, any interested person may file with the Clerk, State Corporation Commission, c/o Document Control Center, P.O. Box 2118, Richmond, Virginia 23218-2118, written comments in this proceeding and shall simultaneously serve a copy on counsel to VNG at the address in Ordering Paragraph (8). On or before November 8, 2005, any interested person desiring to submit comments electronically may do so by following the instructions found on the Commission's website: <http://www.scc.virginia.gov/caseinfo.htm>.



(15) The Commission Staff shall investigate the proposed PBR Plan and the General Rate Case Filing. On or before December 15, 2005, the Staff shall file with the Clerk of the Commission an original and fifteen (15) copies of the Staff's testimony and exhibits and shall serve a copy on counsel to the Company and all respondents.

(16) On or before January 12, 2006, VNG shall file with the Clerk of the Commission an original and fifteen (15) copies of any rebuttal testimony and exhibits and shall serve a copy on Staff and all respondents.

(17) On or before August 15, 2005, VNG shall cause the following notice to be published as display advertising (not classified) in newspapers of general circulation throughout the Company's service territory within the Commonwealth of Virginia:

NOTICE TO THE PUBLIC OF  
VIRGINIA NATURAL GAS, INC.'S  
REQUEST FOR PERFORMANCE BASED  
RATE REGULATION AND  
GENERAL RATE CASE FILING  
CASE NOS. PUE-2005-00057 AND PUE-2005-00062

On July 1, 2005, Virginia Natural Gas, Inc. ("VNG" or the "Company"), filed with the State Corporation Commission ("Commission") an Application for approval of a performance based rate regulation methodology ("PBR Plan") pursuant to § 56-235.6 of the Code of Virginia ("Code"). VNG requests that the Commission approve the PBR Plan so that it becomes effective on January 1, 2006, to allow the Company the opportunity to make investment decisions that will add capacity before the 2007-2008 winter, when VNG states its capacity will be deficient to meet its reserve margin.

In addition, pursuant to the Commission's April 29, 2005, Order on Motions in Case Nos. PUE-2002-00237 and PUE-2005-00028, VNG filed as part of the Application a fully-adjusted cost of service study and the accompanying rate schedules in accordance with the Commission's Rules Governing Utility Rate Increase Applications and Annual Informational Filings, 20 VAC 5-200-30 ("General Rate Case Filing"). The Company states that the General Rate Case Filing supports an increase to its

annual revenues of \$19,212,972, which the Company proposes not to implement if the Commission approves the PBR Plan.

The Company states that the PBR Plan would: (1) freeze the non-gas cost portion of rates for five years beginning January 1, 2006; (2) prohibit the Company from seeking, at the expiration of the five-year freeze, further regulatory treatment on the outstanding portion of any unrecovered purchase premium attendant to AGL Resources Inc.'s acquisition of VNG, representing a potential write-off of approximately \$114 million; (3) allow VNG to request an increase in the frozen rates in connection with (i) any changes in the taxation by the Commonwealth of incumbent natural gas distribution utility revenues, and (ii) any financial distress of VNG beyond its control; (4) forego the Company's proposed \$19,212,972 in additional annual operating revenues; and (5) commit VNG to meet the natural gas capacity needs in Hampton Roads during the rate freeze period.

Next, the Company's General Rate Case Filing includes data to support the additional annual revenue requirement, proposed rate of return, cost of service, rate base, and appropriate capital structure and cost of debt financing. The General Rate Case Filing also includes changes to reflect the use of the interest rate set by the Commission in Case No. PUE-2003-00224 to accrue interest on Customer Deposits and Pipeline Refunds. This rate would be used to compute the interest to be accrued for both the customer deposits and any pipeline refund included in the Company's Quarterly Billing Adjustment ("QBA").

The General Rate Case Filing also provides for rebilling for metering apparatus failure or other factors that result in an incorrect volume of gas being used to compute a customer's bill. Other changes include: (1) a light up charge to apply to appliances (not just furnaces); (2) the accrual of carrying charges on the under-collection or over-collection of gas costs and recovery through the QBA; (3) modification to the methodology for returning Interruptible Sales margins and Interruptible Transportation revenues to Firm Sales customers to provide for sharing of all interruptible margins; (4) an update of the parameters that are used in the QBA calculations; (5) setting the commodity charge equal to the monthly weighted average commodity cost of gas for high load factor firm and general firm gas delivery service; (6) modifications to the calculation of the maximum (ceiling) rate for interruptible gas sales service; (7) revisions to the charges for miscellaneous services; and (8) revisions to Rate Schedules 1

through 12 to reflect the annual revenue increase of \$19,212,972, if implemented.

In addition, the Company states that it has revised Rate Schedule 9 to clarify the Company's current operating procedures relative to a customer's use of its volume imbalance during periods of economic curtailment. The Company states that this is not a change in its operating procedure or a change in the rates charged customers served under this rate schedule.

The Company's request for a PBR Plan is docketed and assigned Case No. PUE-2005-00057. The Company's General Rate Case Filing is docketed and assigned Case No. PUE-2005-00062. The PBR Plan shall not be implemented unless and until approved by the Commission. In addition, the General Rate Case Filing revisions shall not be implemented unless and until approved by the Commission, except that VNG's proposed tariff revisions to Rate Schedule 9 shall be accepted for filing pursuant to § 56-240 of the Code effective August 1, 2005, subject, however, to the power of the Commission, upon investigation thereafter, to fix and order substituted therefor such rate or rates, tolls, charges, rules, or regulations, as shall be just and reasonable.

Interested persons are encouraged to review the proposed PBR Plan, the General Rate Case Filing, and supporting documents. The evidence in this proceeding shall be received concurrently in Case Nos. PUE-2005-00057 and PUE-2005-00062. If the PBR Plan, for example, is not approved or is modified by the Commission in a manner the Company does not choose to accept, the Commission, without additional notice, may take action in the General Rate Case Filing docket establishing just and reasonable rates for VNG. Interested persons should be advised that, after considering all of the evidence, the Commission may approve, reject, or modify the PBR Plan, may approve revenues and adopt rates, fees, charges, and terms and conditions of service that are the same or different from those appearing in the General Rate Case Filing, and/or may apportion revenues among customer classes in a manner that is the same or different from that in the General Rate Case Filing.

Interested persons may review a copy of the Application and the Commission's Order for Notice and Hearing in the Commission's Document Control Center, located on the First Floor of the Tyler Building, 1300 East Main Street, Richmond, Virginia between the hours of 8:15 a.m. and 5:00 p.m., Monday through Friday. A copy of the Application may also be obtained at no cost

by interested persons by making a written request to the Company's counsel, Edward L. Flippen, Esquire, McGuireWoods LLP, 901 East Cary Street, Richmond, Virginia 23219. If acceptable to the requesting party, the Company may provide the Application, with or without attachments, by electronic means. In addition, the Commission's Order For Notice and Hearing and other orders entered in these dockets, the Commission's Rules of Practice and Procedure, as well as other information concerning the Commission and the statutes it administers, may be viewed on the Commission's website at <http://www.scc.virginia.gov/caseinfo.htm>.

A public hearing shall be convened on January 24, 2006, at 10:00 a.m., in the Commission's Courtroom, Second Floor, Tyler Building, 1300 East Main Street, Richmond, Virginia, to receive comments from members of the public and to receive evidence in Case Nos. PUE-2005-00057 and PUE-2005-00062. Any person not participating as a respondent as provided for below may give oral testimony concerning these cases as a public witness at the hearing. Public witnesses desiring to make statements at the public hearing need only appear in the Commission's Second Floor courtroom in the Tyler Building at the address set forth above prior to 9:45 a.m. on the day of the hearing and register a request to speak with the Commission's bailiff.

Any interested person may participate as a respondent in this proceeding by filing, on or before October 3, 2005, an original and fifteen (15) copies of a notice of participation with the Clerk, State Corporation Commission, c/o Document Control Center, P.O. Box 2118, Richmond, Virginia 23218-2118, and shall simultaneously serve a copy of the notice of participation on counsel to VNG at the address above. Pursuant to Rule 5 VAC 5-20-80 of the Commission's Rules of Practice and Procedure, any notice of participation shall set forth: (i) a precise statement of the interest of the respondent; (ii) a statement of the specific action sought to the extent then known; and (iii) the factual and legal basis for the action. Interested parties shall refer in all of their filed papers to Case Nos. PUE-2005-00057 and PUE-2005-00062. Interested persons should obtain a copy of the Commission's Order in this proceeding for additional information about participation as a respondent.

On or before November 8, 2005, any interested person may file with the Clerk of the Commission, at the address set forth above, written comments in this proceeding and shall simultaneously serve a copy on counsel to VNG at the address above. On or before November 8, 2005, any interested person

desiring to submit comments electronically may do so by following the instructions found on the Commission's website: <http://www.scc.virginia.gov/caseinfo.htm>.

VIRGINIA NATURAL GAS, INC.

(18) On or before August 15, 2005, VNG shall forthwith serve a copy of its Application and this Order for Notice and Hearing on the Chairman of the Board of Supervisors and county attorney of each county and on the Mayor or Manager of every city and town (or on equivalent officials in counties, towns, and cities having alternate forms of government) in which VNG provides service. Service shall be made by personal delivery or by first-class mail, postage prepaid, to the customary place of business or residence of the person served.

(19) On or before September 12, 2005, VNG shall file with the Clerk of the Commission proof of the notice required in Ordering Paragraphs (17) and (18).

(20) The Commission's Rules of Practice and Procedure, 5 VAC 5-20-260, *Interrogatories to parties or requests for production of documents and things*, shall be modified for this proceeding as follows: (i) answers shall be served within ten (10) calendar days after receipt of interrogatories or requests for production of documents; (ii) objections shall be served within seven (7) calendar days after receipt of interrogatories or requests for production of documents; and (iii) motions on the validity of any objections shall be filed within ten (10) calendar days of receipt of any objection.

(21) As provided by § 12.1-31 of the Code of Virginia and the Commission's Rules of Practice and Procedure, 5 VAC 5-20-120, *Procedure before hearing examiners*, a hearing examiner is appointed to conduct all further proceedings in these matters on behalf of the Commission and to issue a final report herein.

(22) These matters are continued pending further Order of the Commission.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to:

Edward L. Flippen, Esquire, McGuireWoods LLP, One James Center, 901 East Cary Street,  
Richmond, Virginia 23219-4030; C. Meade Browder, Jr., Senior Assistant Attorney General,  
Division of Consumer Counsel, Office of Attorney General, 900 East Main Street, Second Floor,  
Richmond, Virginia 23219; and the Commission's Office of General Counsel and Divisions of  
Economics and Finance, Energy Regulation, and Public Utility Accounting.